

8-1-1994

Reorganization Schemes under U.K. Insolvency Act of 1986: Chapter 11 as a Springboard for Discussion

Alexandra Rhim

Recommended Citation

Alexandra Rhim, *Reorganization Schemes under U.K. Insolvency Act of 1986: Chapter 11 as a Springboard for Discussion*, 16 Loy. L.A. Int'l & Comp. L. Rev. 985 (1994).
Available at: <http://digitalcommons.lmu.edu/ilr/vol16/iss4/5>

This Notes and Comments is brought to you for free and open access by the Law Reviews at Digital Commons @ Loyola Marymount University and Loyola Law School. It has been accepted for inclusion in Loyola of Los Angeles International and Comparative Law Review by an authorized administrator of Digital Commons@Loyola Marymount University and Loyola Law School. For more information, please contact digitalcommons@lmu.edu.

Reorganization Schemes Under U.K. Insolvency Act of 1986; Chapter 11 as a Springboard for Discussion

I. INTRODUCTION

A global increase in corporate insolvencies¹ has drawn attention to bankruptcy laws. Various economic factors, as well as individual circumstances, are responsible for the upsurge in business failures. High profile bankruptcy cases and the general increase in bankruptcy filings in the United Kingdom,² as well as in the United States,³ raise concerns about the effectiveness of reorganization schemes. The key features of U.K. reorganization are the "administration order" and "voluntary arrangement" procedures. In response to the economic climate, the United Kingdom, in 1985, incorporated a reorganization component into its insolvency law.

The American practitioner may use Chapter 11⁴ as a model

1. Christina Morton, *Insolvency: On the Up and Up, Solving the Insoluble*, INT'L FIN. L. REV. 3, 3 (Spec. Supp. 1990). There has been an increase in corporate failures in the developed nations. *Id.*

2. In general, the United Kingdom experienced an increase in its bankruptcy filing rate during the 1980s; in 1990, the bankruptcy filing rate was three times the 1980 rate. Jagdeep S. Bhandari & Lawrence A. Weiss, *The Untenable Case for Chapter 11: A Review of the Evidence*, 67 AM. BANKR. L.J. 131, 138 n.24 (1993). In England, the director of policy for the British Chambers of Commerce expects that the trend in corporate insolvencies will continue for some time. Jonathan Potts, *Insolvencies in the Fourth Quarter 1992*, 8 TOLLEY'S INSOLVENCY L. & PRAC. 144, 144 (1993).

3. The United States has experienced a significant jump in the bankruptcy filing rates of businesses. During the late 1970s, 8000 firms per year filed for Chapter 11; this rate increased to 24,000 firms in 1991. Gregory E. Maggs, *Bankruptcy As a Business Tool*, 71 TEX. L. REV. 681, 681-82 (1993) (reviewing KEVIN J. DELANEY, STRATEGIC BANKRUPTCY: HOW CORPORATIONS AND CREDITORS USE CHAPTER 11 TO THEIR ADVANTAGE (1992)).

4. Chapter 11 is codified at 11 U.S.C. §§ 1101-1174 (1988 & Supp. V 1993); Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified as amended at 11 U.S.C. §§ 101-1330 (1988 & Supp. V 1993)).

This Comment will discuss Chapter 11 as utilized by the business debtor, although Chapter 11 is available for non-business debtors as well. DAVID G. EPSTEIN ET AL.,

for understanding U.K. reorganization. This approach is useful because the main U.K. reorganization scheme, the administration order procedure, is analogous to Chapter 11. An analysis of Chapter 11's flaws illuminates the current and future weaknesses of U.K. reorganization schemes. The United States has had considerable experience with the implementation of "corporate rescues"; in contrast, the United Kingdom adopted its reorganization schemes in the 1980s.

In analyzing reorganization schemes, this Comment assumes that bankruptcy law is a beneficial "collective system."⁵ Part II of this Comment explores some of the policies and goals underlying the insolvency laws⁶ of the United Kingdom and the United States. Part III examines Chapter 11, highlighting some of its perceived flaws. Finally, Part IV examines the "administration order" and "voluntary arrangement" procedures that are available under the U.K. Insolvency Act of 1986 ("Insolvency Act").⁷ Part IV also examines the effectiveness of management procedures used during reorganization and the suitability of reorganization schemes for small firms.

This Comment reveals that while Chapter 11 influenced U.K. reorganization law, U.K. and U.S. reorganization systems create significantly different incentives. In sum, the Insolvency Act does not provide enough incentives to induce debtors to seek reorganization or to seek it early enough.

II. POLICIES AND GOALS OF THE U.K. AND U.S. INSOLVENCY SYSTEMS

A. *Development of the Insolvency Act*

U.K. reorganization law reflects the recognition that Chapter 11 is a valuable scheme for dealing with corporate insolvencies. The recent Insolvency Act has adopted several features of the U.S.

BANKRUPTCY 734 n.2 (1993).

5. THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* 19 (1986). Bankruptcy law becomes relevant when the rights of numerous creditors must be resolved. *See id.* at 209. *See infra* text accompanying notes 53-56.

6. In the United Kingdom, the term "insolvency" applies to companies, while the term "bankruptcy" applies to individuals and partnerships.

7. Insolvency Act, 1986, ch. 45 (Eng.). The Insolvency Act of 1986 incorporated parts of the Insolvency Act of 1985. For a discussion about the statutes that govern corporate insolvencies, *see infra* notes 104-07 and accompanying text.

bankruptcy system.⁸ Furthermore, many commentators have used U.S. bankruptcy legislation as a “yardstick” for analyzing other bankruptcy systems.⁹

Both U.K. and U.S. insolvency legislative schemes share a common origin; yet, the two systems have diverged in several significant ways.¹⁰ Prior to the enactment of the Insolvency Act, U.K. insolvency law did not contain a reorganization component. Instead, insolvent businesses had only the option of liquidating. “English law thus fell behind other jurisdictions in the lack of a formal procedure for reorganization and reconstruction.”¹¹ By enacting the Insolvency Act, the United Kingdom has been able to approximate procedures analogous to Chapter 11.¹² Accordingly, a few commentators have stated that the U.K. and U.S. systems use different approaches to achieve similar goals.¹³

The large number of corporate and individual insolvencies was a motivating factor behind U.K. insolvency law reform.¹⁴ As a result of these insolvencies, the Secretary of State for Trade directed the formation of a Review Committee, to be headed by Sir Kenneth Cork.¹⁵ In 1982, the Review Committee proposed legislative changes geared towards “fundamental reform of insolvency law.”¹⁶ The focus of the Review Committee was the following:

- (1) to review the law and practice relating to insolvency, bankruptcy, liquidation and receiverships in England and

8. Nicholas A. Aminoff, *The Development of American and English Bankruptcy Legislation—From a Common Source to a Shared Goal*, 10 STATUTE L. REV. 124, 130-34 (1989).

9. *Id.* at 133 n.60.

10. *Id.* at 124. Both U.K. and U.S. insolvency laws, as well as other European bankruptcy laws, stem from the laws of ancient Rome. See DENNIS CAMPBELL, INTERNATIONAL CORPORATE INSOLVENCY LAW 3 (1992). The United States modeled its first bankruptcy statute on U.K. insolvency laws. Aminoff, *supra* note 8, at 124.

11. Hamish Anderson, *Corporate Insolvency After the Insolvency Act 1986*, 20 BRACON L.J. 49, 58 (1988).

12. See generally Aminoff, *supra* note 8 (discussing how recent “English corporate insolvency [law] . . . has openly borrowed from its American cousin”).

13. Philip Carrington & Bennett Murphy, *Reconciling UK Administration and US Chapter 11*, 11 INT’L FIN. L. REV. 20, 22-23 (1992).

14. IAN F. FLETCHER, THE LAW OF INSOLVENCY 12 (1990).

15. *Id.* at 13.

16. *Id.* at 15. In 1982, the Review Committee presented its report to Parliament. INSOLVENCY LAW AND PRACTICE, REPORT OF THE REVIEW COMMITTEE, 1982, CMND 8558, at iii [hereinafter INSOLVENCY LAW AND PRACTICE REPORT].

Wales and to consider what reforms are necessary or desirable;

(2) to examine the possibility of formulating a comprehensive insolvency system and the extent to which existing procedures might, with advantage, be harmonised and integrated;

(3) to suggest possible less formal procedures as alternatives to bankruptcy and company winding up proceedings in appropriate circumstances; and

(4) to make recommendations.¹⁷

In 1984, a later publication—*A Revised Framework for Insolvency Law*, also known as the Government White Paper—incorporated many of the proposals of the Review Committee.¹⁸ The Government White Paper provided substantial guidance for the Insolvency Act of 1985,¹⁹ which was subsequently incorporated into the current Insolvency Act.²⁰

B. General Policies Shared by U.K. and U.S. Bankruptcy Systems

1. Facilitating a Credit-Based Economy

During its early stages, U.K. insolvency law did not advance the policy of credit and trade facilitation. The U.K. insolvency system was originally concerned with "punitive ends and numerous stigma-bearing disqualifications for adjudged bankrupts."²¹ Accordingly, a penal code traditionally accompanied bankruptcy laws.²² Modern U.K. bankruptcy law now embodies a more compassionate attitude toward "unfortunate debtors."²³

17. INSOLVENCY LAW AND PRACTICE REPORT, *supra* note 16, at iii.

18. A REVISED FRAMEWORK FOR INSOLVENCY LAW, 1984, CMND 9175, at 5 [hereinafter REVISED FRAMEWORK]. The Review Committee on Insolvency Law and Practice has completed the most in-depth analysis of insolvency in the history of U.K. insolvency law. ROBERT R. PENNINGTON, PENNINGTON'S CORPORATE INSOLVENCY LAW 2 (1991).

19. See Insolvency Act, 1985, ch. 65 (Eng.) (consolidated and repealed by Insolvency Act, 1986, ch. 45 (Eng.)); PENNINGTON, *supra* note 18, at 2. See generally REVISED FRAMEWORK, *supra* note 18.

20. PENNINGTON, *supra* note 18, at 1; see *infra* note 107 (describing how the Company Directors Disqualification Act of 1986 incorporated parts of the Insolvency Act of 1985).

21. Aminoff, *supra* note 8, at 124.

22. *Id.* at 131.

23. *Id.* at 130.

The United Kingdom enacted the current Insolvency Act against a backdrop of criticism of the government for its failure to encourage commercial and economic development.²⁴ The economic environment in England, particularly the high inflation and the slowdown of the previous "economic boom," has persuaded the United Kingdom to reform its insolvency laws.²⁵ Thus, the focus of current U.K. insolvency law is on promoting investment, trade, and entrepreneurship.²⁶ The Insolvency Act, however, has not become as debtor-oriented as the U.S. Bankruptcy Reform Act of 1978 ("Bankruptcy Code").²⁷

Because "[b]ankruptcy law is a response to credit,"²⁸ bankruptcy systems should aim to "facilitate credit in commercial transactions."²⁹ An economic system based on strict cash transactions would hinder economic development and entrepreneurship.³⁰ Systems based on credit must have a mechanism to promote an efficient and predictable way to account for the flow of credit. An insolvency system allows creditors to plan accordingly because the system provides creditors with the ability to predict the consequences of a bankruptcy.³¹ Hence, in support of the credit facilitation policy, both the United States and the United Kingdom have formulated insolvency laws that provide statutory frameworks for debtor-creditor relations.³²

24. *Id.* at 129.

25. FLETCHER, *supra* note 14, at 12; see also Morton, *supra* note 1, at 3-4.

26. INSOLVENCY LAW AND PRACTICE REPORT, *supra* note 16, at 9-13. "In England, as elsewhere, changes in society and in the commercial life of the community since the Nineteenth Century require the law of insolvency to be reviewed and refashioned to meet the needs of our own time." *Id.* at 9.

27. Hugo Groves, *Insolvency for the General Practitioner: Pt 3*, 89 LAW SOC'Y'S GAZETTE 17, 19 (1992). The Bankruptcy Reform Act of 1978 was enacted as what is known as the Bankruptcy Code. See *supra* note 4.

28. JACKSON, *supra* note 5, at 7.

29. Evan D. Flaschen & Timothy B. DeSieno, *The Development of Insolvency Law as Part of the Transition from a Centrally Planned to a Market Economy*, 26 INT'L LAW. 667, 668 (1992).

30. FLETCHER, *supra* note 14, at 2-3.

31. Flaschen & DeSieno, *supra* note 29, at 668-69.

32. See JACKSON, *supra* note 5, at 7 (discussing the role of credit in the United States). The premise behind credit economies is that there are individuals and commercial entities that continually need to borrow money. *Id.* See also INSOLVENCY LAW AND PRACTICE REPORT, *supra* note 16, at 9-13 (discussing the role of credit in the United Kingdom).

In the United States, Congress enacted the Federal Bankruptcy Statute in 1898, hoping that bankruptcy law would be a vehicle to facilitate trade and commerce. Aminoff, *supra* note 8, at 124. The early American bankruptcy statutes were slanted towards protecting creditors. Now, the Bankruptcy Code is equally, if not more interested in the

2. Encouraging Reorganization

Both the United Kingdom and the United States recognize the premise behind reorganization: a company as a going concern produces more value than if it is liquidated.³³ Congress intended Chapter 11 to help financially troubled corporations to reorganize, rather than undergo liquidation.³⁴ By avoiding liquidation, businesses can maintain their cash flow to continue their operations, which produces more value for unsecured creditors.³⁵ This cash flow also allows businesses to maintain their employees and to continue receiving supplies.³⁶ Thus, the desired result of reorganization is to maximize the assets available to creditors and, thereby, minimize the loss to society.³⁷ In addition, some theorists assert that bankruptcy law is necessary because creditors are unable to formulate mutually acceptable plans on their own without court supervision.³⁸

In the United Kingdom, the Review Committee³⁹ acknowledged the wastefulness and the drawbacks of "winding up,"⁴⁰ and

rehabilitation and the protection of debtors. *Id.* at 124-25. Bankruptcy law was used as a tool to "smooth[] the rough edges of an imperfect" economic system. *Id.* at 124.

33. For a discussion of the premise behind U.S. Chapter 11 reorganization, see H.R. REP. NO. 595, 95th Cong., 1st Sess. 220 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6179. "The premise of a business reorganization is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap. . . . It is more economically efficient to reorganize than to liquidate, because it preserves jobs and assets." *Id.*

For a discussion about the goals behind the U.K. administration order procedure, see PENNINGTON, *supra* note 18, at 300; *see also* Carrington & Murphy, *supra* note 13, at 22 (stating that the "preservation of going-concern values" is the main objective behind U.K. administration and Chapter 11); *see also In re Harris Simons Construction Ltd.*, [1989] 1 W.L.R. 369, 369 (Ch. 1988). "If no administration is made, the company cannot carry on trading. . . . The company will have to go into liquidation more or less immediately." *Id.*

34. *See* H.R. REP. NO. 595, *supra* note 33, at 220 (1977), *reprinted in* 1978 U.S.C.C.A.N. at 6179.

35. ROBERT L. JORDAN & WILLIAM D. WARREN, *BANKRUPTCY* 655-56 (3d ed. 1993). Secured creditors can also potentially benefit, despite their "secured status."

36. *Id.* at 656.

37. Steve Hill, *Company Voluntary Arrangements*, 6 *INSOLVENCY L. & PRAC.* 47, 47 (1990) (discussing the role of U.K. insolvency law).

38. David A. Skeel, Jr., *Markets, Courts, and the Brave New World of Bankruptcy Theory*, 1993 *WIS. L. REV.* 465, 470.

39. *See supra* notes 15-17 and accompanying text.

40. In the United Kingdom, liquidation is most commonly called "winding up," but the two terms are interchangeable. 2 *PALMER'S COMPANY LAW* para. 15.004 (25th ed. 1992).

encouraged "corporate rescues."⁴¹ There is a fairly widespread belief that only the receiver benefits from a "winding up," to the detriment of creditors.⁴² Additional abuses existed where "rogue liquidators" and corporate directors funneled corporate assets into a new corporate entity, while old debts and other liabilities remained with the prior insolvent entities.⁴³ Hence, the new insolvency legislation responded to the need to prevent abuses while encouraging reorganization.

The British Parliament enacted the Insolvency Act to provide a legal framework for "corporate rescues."⁴⁴ The administration order and voluntary arrangement procedures of the Insolvency Act seek to aid companies in financial distress and to help them avoid liquidation.⁴⁵ The administration procedure allows a company to maintain its liquid assets, thereby protecting shareholder and employee interests.⁴⁶ The judicially supervised administration procedure also embodies the goal of "preserving going-concern values."⁴⁷ A few of the statutory "purposes" that are the bases for granting administration orders reflect the policy of maintaining going concern values as well.⁴⁸ Thus, the Insolvency Act represents the initial recognition, by Parliament, of the necessity of reorganizations.

In order to facilitate feasible reorganizations, both the United Kingdom and the United States want financially troubled businesses to seek bankruptcy protection earlier, rather than later.⁴⁹ For

41. See *supra* text accompanying note 17; Diane M. Hare & David Milman, *Corporate Insolvency: the Cork Committee Proposals-I*, 127 SOLIC. J. 230, 231 (1983). The British business community, as well as the Trade Union Congress, welcome the policy of encouraging business reorganizations. *Id.*

42. *The Benefits from Insolvency*, 143 NEW L.J. 1089, 1089 (1993).

43. Anderson, *supra* note 11, at 51.

44. See *id.* at 49.

45. See *supra* text accompanying note 17.

46. See PENNINGTON, *supra* note 18, at 300.

47. Jay L. Westbrook, *A Comparison of Bankruptcy Reorganisation in the US with the Administration Procedure in the UK*, 6 INSOLVENCY L. & PRAC. 86, 87 (1990). While the United Kingdom claims its goal is to aid corporate rescues, many more reorganizations under Chapter 11 result in the continuation of the company. *Id.* at 88.

48. A court will grant an administration order based on the goals of maintaining the "survival of the company" and attaining a "more advantageous realisation of the company's assets than would be effected on a winding up." Insolvency Act, 1986, ch. 45 § 8(3)(a), (d). See *infra* notes 139-40 and accompanying text.

49. See H.R. REP. NO. 595, *supra* note 33, at 220, reprinted in 1978 U.S.C.C.A.N. at 6179 (discussing U.S. bankruptcy goals); Hare & Milman, *supra* note 41, at 231 (discussing U.K. bankruptcy goals).

example, the debtor-in-possession mechanism of Chapter 11, which allows pre-existing managers to retain their positions, may encourage debtors to seek bankruptcy protection at an earlier stage.⁵⁰ The United Kingdom has adopted a similar policy encouraging companies to address their problems at an earlier point in time. Accordingly, the Review Committee had reiterated that one goal was to "devise an insolvency code which will facilitate rescues rather than accelerate failures."⁵¹ In accordance with this goal, a company should make an early attempt at reorganization before creditors have exercised their rights and dismembered the company. Moreover, it is contemplated that an early attempt at reorganization may lessen prejudice to creditors.⁵² Thus, both legal systems attempt to encourage earlier attempts at reorganization to improve a firm's chances of regaining stability.

Preventing creditors from engaging in a "race of diligence" is critical to supporting a reorganization attempt. Both U.K. and U.S. insolvency laws seek to provide a method for the orderly treatment of creditors,⁵³ and to avoid a race to the courthouse to dismember the debtor's assets.⁵⁴ Bankruptcy laws seek to avoid this type of competitive behavior by creditors.⁵⁵ Bankruptcy is a collective approach that enables creditors to work as a group and thus restricts a creditor's potentially self-interested behavior.⁵⁶ Hence, the focus is on preserving the property of the bankruptcy

50. Harvey R. Miller et al., *United States, Solving the Insoluble*, INT'L FIN. L. REV. 50, 51 (Spec. Supp. 1990); see *infra* text accompanying notes 88-90; see discussion *infra* part IV.C.

51. Hare & Milman, *supra* note 41, at 231 (citing INSOLVENCY LAW AND PRACTICE REPORT, *supra* note 16, at 340); see also Hill, *supra* note 37, at 47. But cf. discussion *infra* part IV.C (discussing how, despite the Review Committee's recognition of the need to encourage reorganization, the transfer of control undermines this effort).

52. REVISED FRAMEWORK, *supra* note 18, at 5.

53. INSOLVENCY LAW AND PRACTICE REPORT, *supra* note 16, at 13 (discussing U.K. insolvency law policy).

54. H.R. REP. NO. 595, *supra* note 33, at 340, reprinted in 1978 U.S.C.C.A.N. at 6297. Both the United States and the United Kingdom provide automatic stay or moratorium protection for the debtor as an effort to prevent a "race of diligence."

55. "The automatic stay also provides creditor protection. Without it, certain creditors would be able to pursue their own remedies against the debtor's property." H.R. REP. NO. 595, *supra* note 33, at 340, reprinted in 1978 U.S.C.C.A.N. at 6297.

56. JACKSON, *supra* note 5, at 10; see *supra* text accompanying notes 53-55. A collective bankruptcy system is especially necessary when the debtor cannot pay all of his creditors.

estate in order to increase the chances for an effective reorganization.⁵⁷

III. REVIEW OF CHAPTER 11

The structure of U.K. reorganization is better understood in reference to criticism of Chapter 11. The flaws of Chapter 11 may be indicators of the problems that U.K. reorganizations may also encounter in the near future. This section will explore how the current application of Chapter 11 accords with its underlying goals.

Reorganization under Chapter 11 is not a panacea for all companies in financial distress; companies cannot resort to Chapter 11 protection and always expect to succeed. Bankruptcy laws are not intended to prevent or correct business failures.⁵⁸ Instead, Chapter 11 of the Bankruptcy Code was designed to govern the reorganization of corporations that are truly salvageable. In some instances, assets are inefficiently spent on the maintenance of a troubled business.⁵⁹

A. Strategic Use of Chapter 11

An increased number of corporate failures and the "strategic" use of Chapter 11 have subjected Chapter 11 to close scrutiny. This scrutiny, in turn, has led to discussions in Congress and among commentators about reforming or repealing Chapter 11.⁶⁰ Some commentators believe that Congress may soon address some of these concerns.⁶¹ Nonetheless, the chairman of the National Bankruptcy Conference has stated that, although some changes

57. See, e.g., 11 U.S.C. § 362 (1988 & Supp. V 1993).

58. See JACKSON, *supra* note 5, at 209.

59. *Id.* at 209-10.

60. See Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043, 1078 (1992). Bradley and Rosenzweig boldly argue that "Chapter 11 should be repealed, abolishing court-supervised corporate reorganization." *Id.* This article has received quite a bit of attention from the popular press, academicians, and the judiciary. For an in-depth examination of Bradley and Rosenzweig's article, see Bhandari & Weiss, *supra* note 2. Despite the criticism of Chapter 11, several scholars and judges maintain that Chapter 11 will remain an integral part of business planning. See, e.g., Lisa H. Fenning, *The Future of Chapter 11: One View from the Bench*, 1993-1994 ANN. SURV. BANKR. L. 113-18. "Recent law journal obituaries proclaiming that euthanasia is the only remedy for what ails Chapter 11 are dramatic, but unwarranted." *Id.* at 118.

61. Maggs, *supra* note 3, at 681, 683.

may be necessary, the main structure of Chapter 11 should be left intact.⁶²

The change in the use of bankruptcy has caused alarm. Originally, bankruptcy served a protective function for debtors, yet, more recently, it has changed into a business tool. Thus, Chapter 11 may properly be considered more of a sword than a shield.⁶³ Bankruptcy is no longer a signal of failure and incompetence, but, instead, has become an integral aspect of business planning. Recent bankruptcy cases, such as that of Continental Airlines,⁶⁴ have "increased the visibility of Chapter 11, [and] legitimized bankruptcy as a respectable business option."⁶⁵ The use of bankruptcy law has become strategic because debtors are able to achieve "a limited organizational or political goal that [they] had unsuccessfully pursued outside of the bankruptcy arena."⁶⁶

Some recent Chapter 11 cases reveal the expansive scope of Chapter 11 and the willingness of courts to grant bankruptcy protection. The case of Continental Airlines exemplifies the broad application of Chapter 11. The day after filing bankruptcy, Continental Airlines altered its labor union contracts without obtaining bankruptcy court approval.⁶⁷ Furthermore, Continental Airlines, by availing itself of all statutory protection available under the Bankruptcy Code, was able to remain in business.⁶⁸

Corporations have also filed Chapter 11 when faced with "pending or theoretical liabilities"⁶⁹ rather than imminent financial collapse. For example, 16,000 pending lawsuits, comprised mainly of asbestos claims, prompted the Johns-Manville Corpora-

62. Lynn M. LoPucki, *The Trouble with Chapter 11*, 1993 WIS. L. REV. 729, 757. The National Bankruptcy Conference is a private organization that provided a great deal of guidance in drafting the Bankruptcy Reform Act of 1978. *Id.*

63. See generally Dale Ellis, *The Shield as a Sword: How Major American Corporations Have Used Chapter 11*, 1 FAULKNER & GRAY'S BANKR. L. REV. 31 (1989) (discussing how some large corporations have used Chapter 11 as an "offensive weapon").

64. *In re Continental Airlines Corp.*, 38 B.R. 67 (Bankr. S.D. Tex. 1984).

65. Carl Frankel, *Continental Spreads Its Wings: How Expansion in Chapter 11 Saved an Airline*, 1 FAULKNER & GRAY'S BANKR. L. REV. 10, 10 (1989).

66. Maggs, *supra* note 3, at 686.

67. Frankel, *supra* note 65, at 12; see *Continental Airlines*, 38 B.R. at 69. In reaction to the unilateral alteration of labor union contracts, Congress enacted an amendment to the Bankruptcy Code. See 11 U.S.C. § 1113 (1988) (setting forth how a debtor-in-possession can "assume or reject a collective bargaining agreement").

68. Frankel, *supra* note 65, at 11.

69. Ellis, *supra* note 63, at 31.

tion to file for bankruptcy relief.⁷⁰ The court in *Johns-Manville Corp.* held that a bankruptcy filing caused even by "tort-related" economic pressures is not an abuse of bankruptcy court jurisdiction.⁷¹ In response to this case, one commentator asserts that the corporation filed bankruptcy in an attempt to avoid paying punitive damages to its claimants.⁷² The *Johns-Manville Corp.* bankruptcy case demonstrates how Chapter 11 can enable a "company to reestablish itself as a major American corporate player."⁷³

B. Criticism of Chapter 11

1. Wrong Incentives

Some critics have asked whether the Bankruptcy Code itself generates incentives that encourage businesses to file for bankruptcy.⁷⁴ Some commentators argue that the law creates incentives for managers to file for bankruptcy because the "availability of bankruptcy protection" causes managers to make unwise choices, which then render the company insolvent.⁷⁵ Thus, these commentators claim that bankruptcy is "chosen by, rather than imposed upon, corporate managers."⁷⁶ In contrast, other critics maintain that economic factors cause corporate insolvencies.⁷⁷ Increased corporate leveraging and changes in management structure are some of the reasons why businesses collapse.⁷⁸ The junk bond market, frequent takeover activity, and international competition are other factors that have contributed to the collapse of many American businesses.⁷⁹

The Bankruptcy Code affords the debtor considerable discretion in his treatment of creditors. The Bankruptcy Code

70. *In re Johns-Manville Corp.*, 36 B.R. 727, 729 (Bankr. S.D.N.Y. 1984).

71. *Id.* at 741.

72. Maggs, *supra* note 3, at 685.

73. Ellis, *supra* note 63, at 32. A major factor that led to the reemergence of Johns-Manville Corporation was the bankruptcy court's decision to grant an injunction to prevent further lawsuits even after the close of bankruptcy proceedings. *Id.*

74. See Bhandari & Weiss, *supra* note 2, at 138.

75. Bradley & Rosenzweig, *supra* note 60, at 1047.

76. *Id.* Bradley and Rosenzweig contend that managers *choose* to overburden their firms with debt. *Id.*

77. Bhandari & Weiss, *supra* note 2, at 139-43.

78. *Id.* at 139-40.

79. *Id.* at 139.

empowers debtors with the following powers and protections:⁸⁰ (1) the automatic stay,⁸¹ (2) the ability to assume or reject executory contracts and unexpired leases,⁸² (3) the ability to compel the turnover of bankruptcy estate property,⁸³ (4) the avoidance powers of the debtor-in-possession or trustee,⁸⁴ (5) the debtor's exclusivity period to propose a reorganization plan,⁸⁵ and (6) the ability to obtain confirmation of a reorganization plan without unanimous consent by creditors.⁸⁶ As a result of these statutory powers, some critics assert that the discretion wielded by debtors inappropriately creates incentives that encourage debtors to file for bankruptcy protection.⁸⁷

Some commentators have also criticized the debtor-in-possession procedure,⁸⁸ a salient feature of Chapter 11 that allows existing management to maintain control of the business. This mechanism allows managers to maintain their jobs even if the company seeks reorganization.⁸⁹ Because incumbent management will not be ousted, a debtor will have a strong incentive to pursue

80. Bradley and Rosenzweig have posited the enumerated powers described *infra* in text accompanying notes 81-86. For a discussion of these powers, see Bradley & Rosenzweig, *supra* note 60, at 1045 n.9.

81. See 11 U.S.C. § 362; see *supra* note 80. Section 362 of the Bankruptcy Code provides a stay with respect to the commencement of the "issuance or employment of process, of a judicial, administrative, or other action or proceeding." 11 U.S.C. § 362. The stay also applies to the following: (1) enforcement of a pre-bankruptcy judgment, (2) acts to repossess or exercise control over bankruptcy estate property, (3) acts to "create, perfect, or enforce any lien," (4) acts to "create, perfect, or enforce any lien" before the debtor filed bankruptcy, (5) acts to "collect, assess, or recover a claim" that arose prior to the bankruptcy filing, (6) the "setoff of any debt" that arose before the bankruptcy filing, and (7) the "commencement or continuation of a proceeding before the United States Tax Court." *Id.* § 362(a)(1)-(8) (1988).

82. 11 U.S.C. § 365 (1988 & Supp. V 1993); see *supra* note 80.

83. 11 U.S.C. §§ 542, 543 (1988); see *supra* note 80.

84. 11 U.S.C. §§ 544 (1988 & Supp. V 1993) (strong arm clause), 545 (1988 & Supp. V 1993) (avoiding statutory liens), 547 (1988) (avoiding preferences), 548 (1988 & Supp. V 1993) (avoiding fraudulent transfers), 549 (1988) (avoiding postpetition transactions), 552 (1988) (avoiding postpetition effect of security interest), 553 (1988 & Supp. V 1993) (setoff). See *supra* note 80.

85. 11 U.S.C. § 1121 (1988); see *supra* note 80.

86. 11 U.S.C. §§ 1126, 1129 (1988); see *supra* note 80. A debtor can proceed with cramdown under § 1129(b) as long as one impaired class consents to the proposed plan. 11 U.S.C. § 1129(b).

87. See, e.g., Bradley & Rosenzweig, *supra* note 60, at 1045.

88. Compare *infra* part IV.C (discussing how the absence of a debtor-in-possession procedure in U.K. reorganization schemes creates disincentives).

89. Bradley & Rosenzweig, *supra* note 60, at 1045; LoPucki, *supra* note 62, at 733.

reorganization under Chapter 11.⁹⁰ Although critics have found fault with bankruptcy schemes that encourage premature filing, encouraging debtors to seek bankruptcy protection at an early stage may result in a larger number of successful reorganizations.

2. High Social Costs

There are several bases for the criticism that Chapter 11 reorganizations have a deleterious effect on society. Because Chapter 11 is a vehicle both for the reordering of claims and the collective treatment of creditors, there are serious concerns regarding the cost that bankruptcy imposes on society and the economy.

Creditors may bear a disproportionate loss during a reorganization. Creditors of an insolvent corporation must bear the difference between the corporation's liabilities and its assets.⁹¹ Specifically, when the liabilities of a solvent company exceed its assets, the difference is subtracted from the contributed capital.⁹² In a reorganization, assets are used to maintain operation of the business;⁹³ in a liquidation, those assets would be used to pay prepetition creditors.⁹⁴ Thus, creditors must often shoulder some of the managerial and operational expenses required for the continuation of the business during a reorganization.⁹⁵

Creditors may also potentially bear an economic loss as a result of the automatic stay.⁹⁶ For example, the automatic stay prevents a creditor from seizing the collateral when the debtor defaults on his payments.⁹⁷ A creditor can try to obtain relief from the automatic stay so that he can pursue his remedies.⁹⁸ One commentator asserts that the suspension of payments to

90. See Bradley & Rosenzweig, *supra* note 60, at 1045.

91. Lynn LoPucki, *A General Theory of the Dynamics of the State Remedies/Bankruptcy System*, 1982 WIS. L. REV. 311, 328.

92. *Id.*

93. JORDAN & WARREN, *supra* note 35, at 656.

94. *Id.*

95. *See id.*

96. *Id.* at 661-62. For example, the automatic stay may remain effective to prevent foreclosure or repossession, although the value of the creditor's collateral has decreased. 11 U.S.C. § 362(d) (1988); JORDAN & WARREN, *supra* note 35, at 661-62; *see also supra* note 81.

97. JORDAN & WARREN, *supra* note 35, at 661; *see* 11 U.S.C. § 362.

98. 11 U.S.C. § 362(d) (1988). Yet, a creditor cannot obtain relief from stay if the property is necessary for a reorganization. *Id.* § 362(d)(2)(A). Typically, it is difficult for a creditor to show that the property is not necessary for a reorganization.

creditors creates a "domino effect" because those creditors, in turn, may need to seek bankruptcy protection.⁹⁹ In sum, according to these commentators, the suspension of payments to creditors is potentially harmful to creditors and the economy.¹⁰⁰

Another criticism is that bankruptcy laws induce managers to engage in risky behavior¹⁰¹ that negatively impacts the economy. "[I]f managers know they can keep their jobs and not pay back their debts, they are unlikely to borrow wisely."¹⁰² In addition, when lenders are faced with uncertainty concerning repayment, they may lend less and increase interest rates in order to recoup their losses.¹⁰³ Thus, when creditors suffer a loss, that loss may be passed along to society.

IV. REVIEW OF U.K. REORGANIZATION SCHEMES

The Insolvency Act provides for the following corporate insolvency options: (1) "liquidations," (2) "administrations," (3) "composition schemes" ("including voluntary arrangements under the Insolvency Act and schemes of arrangement under Companies Act"), and (4) "receiverships."¹⁰⁴ Currently, the Insolvency Act,¹⁰⁵ the Insolvency Rules of 1986,¹⁰⁶ and the Company Directors Disqualification Act of 1986¹⁰⁷ are together the statutory

99. LoPucki, *supra* note 62, at 738-39.

100. *See generally id.*

101. *Id.* at 732. LoPucki states that Chapter 11 debtors may make not only unwise, but "reckless" investment decisions. *Id.*

102. *When Firms Fail*, ECONOMIST, Mar. 14, 1992, at 82.

103. *See id.*

104. CAMPBELL, *supra* note 10, at 137. These four insolvency options are codified in "The First Group of Parts" of the Insolvency Act. Insolvency Act, 1986, ch. 45 §§ 1-219.

Administrations and voluntary arrangements are "public procedures." CAMPBELL, *supra* note 10, at 140. Thus, these procedures can be utilized regardless of the security agreement between the debtor and his creditors. *Id.*

105. From the early days of English bankruptcy law, separate statutes existed for individual and corporate debtors. These statutes were consolidated into one statutory scheme by the Insolvency Act. Aminoff, *supra* note 8, at 125.

106. Insolvency Rules of 1986, S.I. 1986, No. 1925, *amended by* S.I. 1989, No. 397, S.I. 1991, No. 380, S.I. 1991, No. 495.

107. Company Directors Disqualification Act, 1986, ch. 46 (Eng.). The Company Directors Disqualification Act of 1986 unified aspects of the Companies Act of 1985 and the Insolvency Act of 1985 in the area of disqualifying people from acting as directors or in related capacities. *See* PENNINGTON, *supra* note 18, at 1. The Company Directors Disqualification Act of 1986 prohibits undischarged bankrupt individuals from becoming directors, taking part in management, or participating in the formation of a corporation. *Id.*

bases for U.K. corporate insolvency. The administration order procedure allows a corporation to reorganize,¹⁰⁸ and the voluntary arrangement procedure enables a corporation to avert a threatened insolvency.¹⁰⁹

In the United Kingdom, the test for insolvency is the inability of a company to pay its debts; this test has three interpretations.¹¹⁰ The first approach, a "balance sheet test,"¹¹¹ is similar to the Bankruptcy Code approach, where insolvency results when a debtor's liabilities exceed his assets.¹¹² The second approach, a "cash flow" standard, focuses on a debtor's ability to pay debts as they become due.¹¹³ The third approach, called the "default-based" test, deems a debtor insolvent if the debtor fails to pay for 21 days on an obligation of £750 or more, or if the debtor does not satisfy a judgment.¹¹⁴ The definition of insolvency is particularly relevant to the process of obtaining an administration order.

A. Administration Orders

The administration order procedure, a significant modification to the U.K. insolvency system, is the U.K. counterpart to Chapter 11. In fact, Chapter 11 is "referred to as one possible model for the [U.K.] administration order procedure."¹¹⁵ One British commentator believes that, had an administration procedure been available earlier, many more firms would have survived.¹¹⁶

The introduction of the administration order procedure signals the adoption of the concept of "corporate rescues" in U.K. insolvency law. For the first time in the United Kingdom, the Insolvency Act provides a framework for a court-based administration procedure.¹¹⁷ This procedure enables a corporation to avoid

108. See *infra* part IV.A.

109. FLETCHER, *supra* note 14, at 334.

110. Jane Murphy & Stephen Pearson, *United Kingdom, Solving the Insoluble*, INT'L FIN. L. REV. 41, 42 (Spec. Supp. 1990); CAMPBELL, *supra* note 10, at 138-39.

111. Anderson, *supra* note 11, at 54; see also CAMPBELL, *supra* note 10, at 138-39.

112. See 11 U.S.C. § 101(32) (Supp. V 1993). The Bankruptcy Code broadly defines insolvency to mean that the debtor's debts and liabilities are greater than his assets. *Id.*

113. Anderson, *supra* note 11, at 54; CAMPBELL, *supra* note 10, at 139.

114. CAMPBELL, *supra* note 10, at 138-39.

115. FLETCHER, *supra* note 14, at 347 n.4.

116. Keith Cuthbertson & John Hudson, *Boom Time for Company Deaths*, 6 INSOLVENCY L. & PRAC. 2, 3 (1990).

117. Insolvency Act, 1986, ch. 45 §§ 8-27.

liquidation, which was required by the Companies Acts.¹¹⁸ Nevertheless, the administration order procedure is still closely associated with liquidation.¹¹⁹ While a non-court-based administration procedure previously existed under the Companies Act of 1985,¹²⁰ the Insolvency Act has now replaced it with a court-based procedure.¹²¹ The current Insolvency Act has incorporated aspects of the Insolvency Act of 1985, which also included administration provisions.¹²²

Since the enactment of the Insolvency Act, successful reorganizations under the administration order procedure reveal that administration can be a practicable solution for corporate insolvencies. Several large British corporations have obtained administration orders and continue to exist as going concerns.¹²³ In the Polly Peck International ("Polly Peck") administration proceeding,¹²⁴ for example, the administrators expected creditors to receive a much larger share of corporate assets through an administration scheme than they could have realized under a liquidation.¹²⁵ Thus, the strategy in that case was to maximize the realization of Polly Peck's assets, even though the process might span several years.¹²⁶

1. Obtaining an Administration Order

Administration is a court-based procedure that allows a corporation to make arrangements with its creditors, thus permitting the business to continue its operations.¹²⁷ A company may

118. Aminoff, *supra* note 8, at 125.

119. Carrington & Murphy, *supra* note 13, at 20. The process of obtaining an administration order models the liquidation process. FLETCHER, *supra* note 14, at 360. Thus, unlike the attitude towards Chapter 11, there is a stigma attached to the administration procedure. Carrington & Murphy, *supra* note 13, at 20.

120. Companies Act, 1985, ch. 6 (Eng.).

121. It was difficult to devise a scheme under the Companies Act because it was difficult to obtain the required majorities. James Lingard, *Corporate Rescues—The Need for Reform*, 7 INT'L FIN. L. REV. 14, 14 (1988).

122. FLETCHER, *supra* note 14, at 346; *see also supra* notes 7, 19 and accompanying text.

123. Malcolm Cohen & Charles Pascoe, *Surviving Along the Administration Route*, 88 LAW SOC'Y'S GAZETTE 24, 24 (1991).

124. *Re A Company No. 009296 of 1990*, 1992 BCC 510 (Ch. 1992) (LEXIS, Enggen Library, Cases File).

125. Brenda Hannigan, *Company Law*, 141 NEW L.J. 1040, 1040 (1991). The administrators predicted that an administration would provide 50 pence on the pound, while a liquidation would provide creditors with only 20 pence. *Id.*

126. *Id.*

127. *See* PENNINGTON, *supra* note 18, at 300.

obtain an administration order as long as a secured creditor does not appoint an administrative receiver who refuses to consent to the administration order.¹²⁸ The administration order procedure is intended to serve only as a temporary procedure that will give the debtor a brief respite from his creditors.¹²⁹ An appointed administrator decides whether parts of the business will be sold or will continue to operate.¹³⁰ Once a debtor has entered into administration, liquidation of the whole or part of the corporation is still possible. Once a corporation has commenced liquidation, however, it cannot obtain an administration order.¹³¹

The Insolvency Act specifies (1) the types of companies that are qualified to obtain an administration order, and (2) which individuals or entities can apply for an order. In order to qualify for an administration order, a company must be registered either under the Companies Act of 1985¹³² or under previous Companies Acts.¹³³ "An application to the court for an administration order shall be by petition presented either by the company or the directors, or by a creditor or creditors (including any contingent or prospective creditor or creditors), or by all or any of those parties, together or separately."¹³⁴ Also, the Insolvency Act will not allow "individual members" or individual shareholders, in such capacities, to petition for an administration order.¹³⁵

In order for a company to pursue an administration, it must satisfy two conditions: (1) the inability to pay its debts,¹³⁶ and (2) the likelihood of achieving one or more of its authorized specified "purposes."¹³⁷ The petition must specifically state the "purpose" of an administration. The petitioner must persuade the court that the "purpose" is at least one or more of the following: (1) survival

128. Insolvency Act, 1986, ch. 45 § 10(3).

129. CAMPBELL, *supra* note 10, at 154.

130. Philippe Aghion et al., *The Economics of Bankruptcy Reform*, 8 J.L. ECON. & ORGANIZATION 523, 530 (1992).

131. Insolvency Act, 1986, ch. 45 § 8(4).

132. *See supra* note 120.

133. PENNINGTON, *supra* note 18, at 301. In contrast to Chapter 11, which applies to business and non-business debtors, the administration order procedure under the Insolvency Act only applies to companies. FLETCHER, *supra* note 14, at 346.

134. Insolvency Act, 1986, ch. 45 § 9(1), *amended by* Companies Act, 1989, ch. 40, sched. 16 (Eng.).

135. PENNINGTON, *supra* note 18, at 302.

136. Insolvency Act, 1986, ch. 45 § 8(1)(a). For a discussion about the test for insolvency, see *supra* text accompanying notes 110-14.

137. Insolvency Act, 1986, ch. 45 § 8(1)(b).

of the company, or at least a part of it; (2) "approval of a voluntary arrangement" under the Insolvency Act; (3) sanction of a compromise under section 425 of the Companies Act of 1985¹³⁸ or an "arrangement"; or (4) a better realization of assets, through a reorganization, than what is possible through a liquidation.¹³⁹ Most often, the proponent will obtain an administration order by persuading the court that the company, or a portion of it, will survive, or that an administration will produce better realization of assets than would a liquidation.¹⁴⁰ In support of the petition, most companies present a report, from an independent source, concerning the practicability of an administration.¹⁴¹

The proponent of the administration plan bears the burden of presenting evidence to satisfy both prongs—that the company cannot pay its debts and that the order is "likely to achieve" the proposed "purpose(s)."¹⁴² The court in *Re Consumer and Industrial Press Ltd.*¹⁴³ concluded that the first prong—the inability to pay debts—was satisfied on the basis of the company's balance sheet, which reflected a deficit of over £130,000.¹⁴⁴ Several courts have supplied different interpretations of the second prong, which is the "likely to achieve" requirement of section 8(1)(b).¹⁴⁵ Some courts, such as the *Re Rowbotham Baxter Ltd.*¹⁴⁶ court, have interpreted the language as requiring a "real prospect";¹⁴⁷ other courts have applied "more probably than

138. Companies Act, 1985, ch. 6 § 425. See section 427 for the "provisions for facilitating company reconstruction and amalgamation." *Id.* § 427.

139. Insolvency Act, 1986, ch. 45 § 8(3)(a)-(d). For a discussion about the "purposes" of an administration, see PENNINGTON, *supra* note 18, at 304-07.

140. Insolvency Act, 1986, ch. 45 § 8(3)(a), (d); Groves, *supra* note 27, at 18.

141. Typically, the insolvency practitioner prepares and presents the report. Groves, *supra* note 27, at 17.

142. PENNINGTON, *supra* note 18, at 308; see *supra* text accompanying notes 139-40.

143. 1988 PCC 436 (Ch. 1987).

144. *Id.* at 439.

145. One commentator suggests a lower standard, which would enable a court to grant an order as long as the administration order petition is *reasonable*. Hill, *supra* note 37, at 57.

146. 1990 BCLC 397 (Ch. 1989).

147. *Id.* at 397. The *Rowbotham* court dismissed the administration order petition because there was no "real prospect" that the company could achieve any of its "purpose(s)." The ruling was based on the following reasons: (1) it would be difficult to "ascertain who would be the persons entitled to attend a meeting to approve the voluntary arrangement," and (2) there was insufficient funding to sustain an administration. *Id.*

not”¹⁴⁸ and “just more likely than not”¹⁴⁹ standards. One commentator indicates that there is no real discernible or meaningful distinction among these standards.¹⁵⁰ If the proponent cannot meet the burden of proof on both prongs, liquidation of the company will ensue.

If a court is satisfied that the proponent has met all the requisite conditions, the court has discretion to grant an administration order.¹⁵¹ The court has discretion to consider “off-setting” factors that weigh against granting an order, even if it is likely that the administration would achieve one or more of its statutory “purposes.”¹⁵² In deciding whether to grant an order, the court will balance interests to assess the benefits of an administration over a liquidation.¹⁵³ For example, in *Consumer and Industrial Press Ltd.*, the court evaluated the benefits that secured creditors would receive,¹⁵⁴ even though the statutory “purposes” could have been achieved with an administration order.

Once an administration order is in place, a statutory moratorium provides the debtor with a “breathing spell.”¹⁵⁵ The moratorium is similar to the automatic stay provided by the Bankruptcy Code.¹⁵⁶ While a moratorium is in effect, the corporation cannot be liquidated, acts to enforce liens are prohibited, an administra-

148. *Consumer and Indus. Press Ltd.*, 1988 PCC at 439. The *Consumer* court was satisfied that an administration order would allow a reorganization that would produce more value than a liquidation. The court relied on evidence that the company had reduced its overhead, which would enable the company to once again be profitable. Thus, the court granted the administration order and dismissed the “winding up” petition. *Id.* at 440-42. The court in *Harris Simons Construction* criticized the *Consumer* court for setting the “standard of probability too high.” *In re Harris Simons Construction Ltd.*, [1989] 1 W.L.R. 369, 370 (Ch. 1988).

149. Sally Wheeler, *Insolvency Act 1986 Part II—A Look at Current Judicial Attitudes*, 7 TOLLEY’S INSOLVENCY L. & PRAC. 69, 70 (1991) (citing *Re Chelmsford City Football Club*, 1991 BCC 133 (Ch. 1991)).

150. *Id.*

151. Insolvency Act, 1986, ch. 45 § 8(1)(a), (b); *Rowbotham Baxter*, 1990 BCLC at 399.

152. FLETCHER, *supra* note 14, at 351.

153. *Id.*

154. *Consumer and Indus. Press Ltd.*, 1988 PCC at 442.

155. Insolvency Act, 1986, ch. 45 § 11(3). The Insolvency Act provides protection to the debtor upon presentation of the application for an administration order. *See id.* § 10(1); *see also infra* note 157 and accompanying text.

156. *See* 11 U.S.C. § 362; *see also supra* note 81 and accompanying text.

tive receiver cannot be appointed, and other proceedings cannot be commenced without leave of court.¹⁵⁷

2. Creditors

The administration order procedure significantly alters some rights traditionally held by secured creditors.¹⁵⁸ For example, section 15 of the Insolvency Act permits an administrator to dispose of assets subject to a security interest if the disposition would promote the "purpose(s)" of the administration order.¹⁵⁹ Thus, secured creditors must yield or compromise in order to allow the debtor to attempt reorganization.¹⁶⁰ The secured creditor must take the initiative to safeguard his own rights.¹⁶¹

The Insolvency Act sets out some of the protections available to creditors and members of a corporation.¹⁶² A creditor or member may apply to the court to protect his interests in the following circumstances: (1) if the company's affairs are being managed in a manner that is prejudicial to the creditor or member, or (2) if an "actual or proposed act or omission of the administrator is or would be so prejudicial."¹⁶³ The language of section 27 is purposefully broad, and the court's powers are commensurately expansive.¹⁶⁴ Thus, as a protective measure, the court can pre-

157. Insolvency Act, 1986, ch. 45 § 11(3)(a)-(d).

During the period for which an administration order is in force—

(a) no resolution may be passed or order made for the winding up of the company;

(b) no administrative receiver of the company may be appointed;

(c) no other steps may be taken to enforce any security over the company's property, or to repossess goods in the company's possession under any hire-purchase agreement, except with the consent of the administrator or the leave of the court and subject (where the court gives leave) to such terms as the court may impose; and

(d) no other proceedings and no execution or other legal process may be commenced or continued, and no distress may be levied, against the company or its property except with the consent of the administrator or leave of the court and subject (where the court gives leave) to such terms as aforesaid.

Id.

158. Hamish Anderson, *Administration: Rights of Secured Creditors*, 6 *INSOLVENCY L. & PRAC.* 130, 130 (1991).

159. Insolvency Act, 1986, ch. 45 § 15(1), (2).

160. Anderson, *supra* note 158, at 137.

161. *Id.*

162. *See* Insolvency Act, 1986, ch. 45 § 27.

163. *Id.* § 27(1)(a)-(b).

164. FLETCHER, *supra* note 14, at 381; *see* Insolvency Act, 1986, ch. 45 § 27.

scribe specific directions to regulate an administrator's managerial powers.¹⁶⁵

In general, secured creditors and lenders have more discretion in an administration under the Insolvency Act than in a Chapter 11 reorganization.¹⁶⁶ Creditors from the United States and the United Kingdom can exercise some monitoring authority through the appointment of creditors' committees.¹⁶⁷ Section 26 of the Insolvency Act enables creditors to form their own committees by their own initiative.¹⁶⁸ Creditors' committees, either under the Insolvency Act or the Bankruptcy Code, have few formal powers. Hence, a U.K. creditors' committee has "no coercive or directory powers which may be exercised in relation to the administrator."¹⁶⁹ The Review Committee envisioned that a continuous flow of information to creditors regarding the progress of the administration was a necessary component of insolvency law.¹⁷⁰ This supply of information enables creditors to evaluate the effectiveness of an administration, in light of the proposed "purpose(s)."¹⁷¹

In some instances, creditors are able to circumvent the moratorium and other effects of an administration order. An administration order freezes a creditor's ability to enforce liens or commence other proceedings against the debtor unless the court permits the creditor to act.¹⁷² If a creditor obtains leave of court, the court may allow him to commence proceedings against the debtor.¹⁷³ A court will grant leave if a creditor can persuade the

165. FLETCHER, *supra* note 14, at 381.

166. See Westbrook, *supra* note 47, at 87.

167. See 5 COLLIER ON BANKRUPTCY ¶ 1103.07, at 1103-25 (Lawrence P. King ed., 15th ed. 1993) (discussing creditors' committees in the United States); FLETCHER, *supra* note 14, at 380-81 (discussing creditors' committees in the United Kingdom).

168. Insolvency Act, 1986, ch. 45 § 26(1). "Where a meeting of creditors summoned under section 23 has approved the administrator's proposals (with or without modifications), the meeting may, if it thinks fit, establish a committee ('the creditors' committee') to exercise the functions conferred on it by or under this Act." *Id.*

169. FLETCHER, *supra* note 14, at 381. It may appear that a creditors' committee does not fulfill a substantial role in the administration process; however, the flow of information and monitoring is important. *Id.*

170. *Id.* at 380-81.

171. *Id.* at 381.

172. PENNINGTON, *supra* note 18, at 321; see *supra* note 157 and accompanying text.

173. See Insolvency Act, 1986, ch. 45 § 11(3); see *supra* note 157; cf. 11 U.S.C. § 362(d)(1), (2).

court of a "good reason" to depart from the administration order.¹⁷⁴ "The administrator should . . . give effect to the creditor's rights, unless to do so would prevent or impede the administrator achieving the purposes for which the administration order was made."¹⁷⁵ Nonetheless, courts are reluctant to grant leave to secured creditors after an administration order is already in effect.¹⁷⁶

3. Discharge

A discharge, which concludes an administration, will return the debtor and the creditors to the positions they were in prior to the administration order.¹⁷⁷ Because debtors can no longer seek moratorium protection provided by an administration, creditors can resume exercising their pre-existing legal remedies.¹⁷⁸ For example, creditors can resume their normal debt collection remedies, although certain transactions voided during the course of the administration remain invalid.¹⁷⁹

A court may grant a discharge on several grounds. First, the administrator can apply to the court for a discharge when the "purpose(s)" of the "proposal" have been achieved or if it appears that the "purpose(s)" cannot be fulfilled.¹⁸⁰ A common reason for applying for discharge is the failure to achieve the "purposes" underlying the administration order.¹⁸¹ In such a situation, the court may order a "winding up" of the company after granting a discharge.¹⁸² Through a resolution, creditors can also require that the administrator apply for discharge.¹⁸³ Second, another typical ground for discharge is creditor disapproval of the "proposals" of the administration order.¹⁸⁴

174. PENNINGTON, *supra* note 18, at 320; cf. 11 U.S.C. § 362(d)(1), (2).

175. PENNINGTON, *supra* note 18, at 321.

176. *Id.* at 320.

177. *Id.* at 355-56; see Insolvency Act, 1986, ch. 45 § 18.

178. PENNINGTON, *supra* note 18, at 355-56.

179. See *id.* at 356. For example, transfers analogous to preferential and fraudulent transfers under the Bankruptcy Code remain invalid after the discharge of an administration order. See *id.*

180. Insolvency Act, 1986, ch. 45 § 18(2)(a); PENNINGTON, *supra* note 18, at 354-55.

181. PENNINGTON, *supra* note 18, at 355.

182. *Id.* at 356-57.

183. Insolvency Act, 1986, ch. 45 § 18(2)(b).

184. *Id.* § 24(5); PENNINGTON, *supra* note 18, at 355; cf. 11 U.S.C. § 1129.

Third, the same discharge procedure also applies if the administrator wishes to change the original administration order to specify an alternative "purpose" that is possible to achieve.¹⁸⁵ This route does not conclude the administration; rather, it is a method to articulate another "purpose" that is attainable, thus enabling the debtor to continue the reorganization attempt.

B. Voluntary Arrangements

Voluntary arrangements enable a company to make agreements or compromises with other third parties who have rights against the company.¹⁸⁶ A company can either (1) enter into an agreement to alter rights, even when there is no current dispute,¹⁸⁷ or (2) formulate an arrangement to pay either the whole debt or a portion of it back to creditors.¹⁸⁸ Thus, in hopes of completing payment for its debts, a company can use the procedure to alter creditors' rights or to gain an extension.

1. Obtaining a Voluntary Arrangement

Under the Insolvency Act, the voluntary arrangement procedure is closely connected to the administration order procedure. Companies can propose voluntary arrangements alone or in conjunction with an administration.¹⁸⁹ A debtor can simultaneously propose a voluntary arrangement and an administration order because a voluntary arrangement can be one of the specified "purposes" of an administration order.¹⁹⁰ Often, a company will devise a voluntary arrangement "under the umbrella of an administration" because there is no effective moratorium after the approval of a voluntary arrangement.¹⁹¹ In contrast to administrations, parties can enter into voluntary arrangements even when the company is about to be liquidated.¹⁹²

185. Insolvency Act, 1986, ch. 45 § 18(1); PENNINGTON, *supra* note 18, at 355.

186. PENNINGTON, *supra* note 18, at 358.

187. *Id.* at 359. Companies have implied powers to enter into arrangements, whether there is a current dispute or not. *See id.* at 358.

188. *Id.* at 359.

189. *See* Insolvency Act, 1986, ch. 45 § 3(a).

190. *Id.* § 8(3)(b).

191. Groves, *supra* note 27, at 18; *see* FLETCHER, *supra* note 14, at 334-35; *see infra* part IV.B.2.

192. Insolvency Act, 1986, ch. 45 § 3(b); PENNINGTON, *supra* note 18, at 358.

The Insolvency Act incorporated the voluntary arrangement procedure in response to the need for a simple method by which a corporation and its creditors could formulate a legally binding agreement.¹⁹³ Although voluntary arrangements were possible under the Companies Acts prior to the enactment of the Insolvency Act, they were more complicated and required more expense.¹⁹⁴ In order to encourage corporations to participate in voluntary arrangements, the Review Committee proposed an arrangement that would not require a court order to make the scheme binding on the parties.¹⁹⁵ The result is the voluntary arrangement procedure, which parties can conduct either as a court-based or non-court-based procedure.¹⁹⁶ If conducted without court intervention, parties can enter into an agreement under the supervision of an insolvency practitioner.¹⁹⁷ Moreover, because there is no requirement that the company be registered under the current or previous Companies Acts, many more companies can employ the procedure.¹⁹⁸ Although a voluntary arrangement is less complex and less costly than the administration order procedure, it is still far less utilized than the administration order procedure.¹⁹⁹

Directors of a company,²⁰⁰ an administrator,²⁰¹ or a liquidator²⁰² can commence a voluntary arrangement by presenting

193. FLETCHER, *supra* note 14, at 333.

194. Lingard, *supra* note 121, at 14; CAMPBELL, *supra* note 10, at 140; FLETCHER, *supra* note 14, at 333. While voluntary arrangements are more often pursued under the guidance of the Insolvency Act, they are still possible under the Companies Act. CAMPBELL, *supra* note 10, at 140. The Companies Act mandates a cumbersome majority requirement for class meetings. Lingard, *supra* note 121, at 14.

195. INSOLVENCY LAW AND PRACTICE REPORT, *supra* note 16, at 102-03. While a court order is not necessary to bind the parties, the court has a limited amount of control over the process. The court can revoke or suspend the approval given at meetings, and if the meetings demonstrate a "material irregularity," the parties will have to revise or reconsider the proposal. FLETCHER, *supra* note 14, at 343.

196. Anderson, *supra* note 11, at 59.

197. Murphy & Pearson, *supra* note 110, at 47.

198. PENNINGTON, *supra* note 18, at 381. Compare *supra* text accompanying notes 132-33 (stating that a company must be registered under the Companies Acts to qualify for the administration order procedure).

199. CAMPBELL, *supra* note 10, at 155; see *infra* part IV.B.2.

200. Insolvency Act, 1986, ch. 45 § 1(1). "(1) The directors of a company . . . may make a proposal under this Part to the company and to its creditors for a composition in satisfaction of its debts or a scheme of arrangement of its affairs . . ." *Id.*

201. *Id.* § 3(a); see *supra* text accompanying note 189.

202. Insolvency Act, 1986, ch. 45 § 3(b); see *supra* text accompanying note 192.

a "proposal" to the company and creditors. The Insolvency Act does not clearly define the terms that a "proposal" must contain.²⁰³ Unlike an administration, which requires the proponent to prove the company's inability to pay its debts,²⁰⁴ a voluntary arrangement can be proposed even when the company is not insolvent.²⁰⁵

The company and its creditors must convene to discuss whether to approve and/or modify the voluntary arrangement.²⁰⁶ All creditors known to the company must receive notice of creditors' meetings.²⁰⁷ The rights of secured creditors are safeguarded by the requirement that creditors must "concur" with a "proposal" that alters their rights.²⁰⁸ Once the voluntary arrangement is approved, it binds every person who received proper notice and was entitled to vote in the approval process.²⁰⁹ One potential disadvantage is that the arrangement does not bind creditors who do not receive proper notice.²¹⁰ Nevertheless, the notified parties may implement the voluntary arrangement, unless it is challenged. Unfair prejudice to creditors or "material irregularity at or in relation to . . . the meetings" are grounds to challenge the approval of the "proposal."²¹¹

Courts grant a significant amount of freedom to fashion schemes under the voluntary arrangement procedure in order to encourage companies to "initiate schemes of the widest variety."²¹² Courts have intentionally refrained from defining the types of schemes they will approve.²¹³ Nonetheless, court-approved schemes have fallen into three broad categories. These schemes include "capitally insufficient companies,"²¹⁴ reorganiza-

203. FLETCHER, *supra* note 14, at 335.

204. See *supra* text accompanying note 136.

205. FLETCHER, *supra* note 14, at 334.

206. Insolvency Act, 1986, ch. 45 § 3, 4(1); see FLETCHER, *supra* note 14, at 339.

207. CAMPBELL, *supra* note 10, at 155.

208. Insolvency Act, 1986, ch. 45 § 4(3); CAMPBELL, *supra* note 10, at 155.

209. FLETCHER, *supra* note 14, at 342. The arrangement is binding upon parties as long as they had the opportunity to vote. It is not required that the creditors be "present or represented at the meeting." *Id.*

210. Murphy & Pearson, *supra* note 110, at 47.

211. Insolvency Act, 1986, ch. 45 § 6(1)(a), (b); FLETCHER, *supra* note 14, at 343. For the various steps a court can take when presented with a challenge to an arrangement, see Insolvency Act, 1986, ch. 45 § 6(4)(a), (b).

212. PENNINGTON, *supra* note 18, at 383.

213. *Id.*

214. *Id.* at 384. The scheme would alter the rights of the members or creditors. *Id.*

tions,²¹⁵ and "reconstructions, mergers or divisions."²¹⁶ In general, courts will approve a scheme as long as it is fair to all affected parties.²¹⁷

2. Lack of Moratorium in Voluntary Arrangements

A major drawback of the voluntary arrangement procedure is the lack of moratorium protection during the time period between the presentation of a "proposal" and the implementation of the arrangement.²¹⁸ Without a moratorium, which is a fundamental bankruptcy protection, "creditors could continue their dismemberment processes, and any hopes of reorganization would be rendered meaningless."²¹⁹ Because creditors can exercise their rights before a moratorium is in effect, the company may no longer exist by the time it is able to implement an arrangement.²²⁰ In order to compensate for the missing moratorium, voluntary arrangements are often used in conjunction with administration orders.²²¹

Using both the voluntary arrangement and the administration procedures may be too cumbersome or costly for some debtors. Therefore, it is more likely that companies will opt to use the administration procedure alone for its immediate moratorium, rather than coupling it with a voluntary arrangement. One scholar predicts that this drawback will discourage companies from pursuing voluntary arrangements, an otherwise potentially valuable procedure.²²² In fact, statistics reveal that companies use the voluntary arrangement procedure far less often than the administration order procedure.²²³ If moratorium protection were to become available in the future, it is likely that an increased number of debtors would employ the voluntary arrangement procedure.

215. *Id.* at 385. Reorganizations alter shareholders' and lenders' rights, or allow the company to raise new funds or restructure its capital structure. *Id.*

216. *Id.* at 382.

217. *Id.* at 383.

218. CAMPBELL, *supra* note 10, at 156; FLETCHER, *supra* note 14, at 334-35.

219. RICHARD F. BROUDE, REORGANIZATIONS UNDER CHAPTER 11 OF THE BANKRUPTCY CODE § 3.01, at 4-2 (1993).

220. Hill, *supra* note 37, at 48.

221. See CAMPBELL, *supra* note 10, at 156; FLETCHER, *supra* note 14, at 335.

222. FLETCHER, *supra* note 14, at 335.

223. Between 1987 and 1989, the number of voluntary arrangements constituted less than 25% of the total number of administrations. Hill, *supra* note 37, at 47.

C. Management During Administrations and Voluntary Arrangements

The U.K. and U.S. insolvency regimes offer fundamentally different approaches regarding the exercise of management control during insolvency proceedings.²²⁴ In an administration, control is abdicated to a new agent, who is independent of pre-existing management. In a voluntary arrangement, a "nominee" will exercise some control, but the transfer of managerial control is not as drastic as in administrations.²²⁵ Several British commentators argue that management by parties other than the pre-existing company managers and owners creates disincentives,²²⁶ which decrease the chances that a firm will seek reorganization.²²⁷ While Parliament may have had Chapter 11 in mind, the U.K. reorganization framework did not incorporate the Chapter 11 debtor-in-possession management model. After comparing the management mechanisms of the Insolvency Act to those of Chapter 11, British commentators have favorably reviewed the U.S. debtor-in-possession procedure.²²⁸

1. Chapter 11 Debtor-in-Possession

In the United States, once a debtor files a case under Chapter 11, existing management may continue to operate and manage the business as the debtor-in-possession.²²⁹ In many Chapter 11 cases, the debtor-in-possession remains the "focal point."²³⁰ The debtor-in-possession is the same entity as the debtor, but is "empowered by virtue of the Bankruptcy Code to deal with its contracts and property in a manner it could not have done absent the bankruptcy filing."²³¹ Also, the debtor-in-possession has a

224. See Lingard, *supra* note 121, at 14. Lingard points out that the United States and the United Kingdom have completely different attitudes regarding who should remain in control. *Id.*

225. See Harry Rajak, *Company Rescue*, 9 TOLLEY'S INSOLVENCY L. & PRAC. 111, 111 (1993).

226. See Hill, *supra* note 37, at 51.

227. *Id.* In contrast, U.S. critics have assailed the U.S. debtor-in-possession procedure for creating the wrong incentives that induce debtors to file for bankruptcy prematurely or inappropriately. See *supra* text accompanying notes 88-90.

228. See Lingard, *supra* note 121, at 14-15. See generally Hill, *supra* note 37.

229. See 11 U.S.C. § 1101(1) (1988).

230. BROUDE, *supra* note 219, at 3-5.

231. *Id.* at 3-2 to 3-3 nn. 9-10; see *supra* text accompanying notes 81-84.

fiduciary duty to manage responsibly and conserve the bankruptcy estate for the benefit of creditors.²³² An appointed trustee will replace the debtor-in-possession only when there is fraud or incompetence, or when it is in the interest of creditors.²³³ The court will not "scrutinize or entertain objections to ordinary course transactions."²³⁴ Generally, the debtor-in-possession remains autonomous in operating the company.

Prevalent social attitudes about debtors explain in part the absence of a debtor-in-possession mechanism in the United Kingdom. In contrast to the U.S. debtor, the U.K. debtor is not the focus of a reorganization attempt.²³⁵ Britons adopt the "prevailing view . . . that the prior owners were the ones whose venality or incompetence created the problem";²³⁶ hence, a new agent should exercise control. Because threads of a retributive attitude toward debtors still remain, pre-existing management does not get a second chance during the reorganization stage.²³⁷ Similarly, other countries that espouse "harsher societal attitudes" against debtors have declined to adopt the debtor-in-possession mechanism.²³⁸

2. Administrations

In a U.K. administration, pre-existing management does not exercise control over the company. The court appoints an administrator who is a licensed practitioner.²³⁹ The majority of these practitioners are accountants, but a minority are solicitors.²⁴⁰ Initially, the administrator prepares "proposals" regarding how the underlying "purposes" of the administration order will be achieved.²⁴¹ The administrator's main function is to manage

232. BROUDE, *supra* note 219, at 3-4.

233. 11 U.S.C. § 1104(a)(1)-(2) (1988). Replacing the debtor-in-possession with a trustee is a drastic remedy. Miller et al., *supra* note 50, at 54. There is a strong presumption that the debtor will remain in control of the insolvent corporation.

234. EPSTEIN ET AL., *supra* note 4, at 740.

235. Compare *supra* text accompanying note 230. In the United Kingdom, the insolvency practitioner is the intended focus of the Insolvency Act. CAMPBELL, *supra* note 10, at 138.

236. Westbrook, *supra* note 47, at 88.

237. See Hill, *supra* note 37, at 52; see Westbrook, *supra* note 47, at 88.

238. Flaschen & DeSieno, *supra* note 29, at 683.

239. Anderson, *supra* note 11, at 51; see Insolvency Act, 1986, ch. 45 § 13(1).

240. Anderson, *supra* note 11, at 51.

241. See Insolvency Act, 1986, ch. 45 §§ 14(1)(a), 17(1)-(2); PENNINGTON, *supra* note 18, at 327.

the corporation, including the exercise of control over corporate property.²⁴² The administrator acts as an agent of the corporation,²⁴³ however, he is not personally liable for the contracts he enters into in the course of his activities as an administrator.²⁴⁴ While the administrator must follow court orders, he has "general power" to make managerial decisions concerning the corporation.²⁴⁵

3. Voluntary Arrangements

The voluntary arrangement procedure also does not effectively leave pre-existing management in place. Although the original management remains, a new nominee acts as a "trustee or otherwise for the purpose of supervising" the implementation of the voluntary arrangement.²⁴⁶ In order to maintain a level of competence and to combat prior abuses under the previous laws, the Insolvency Act requires that a qualified insolvency practitioner serve as nominee.²⁴⁷ Upon approval of the voluntary arrangement scheme, the directors must transfer possession of the corporate assets to the nominee.²⁴⁸ Thus, the nominee exercises substantial control.

4. Incumbent Management Should Remain

Transferring either all or partial managerial control to an administrator or an insolvency practitioner creates disincentives which discourage debtors from seeking reorganization. Many British practitioners are concerned about the disincentives created by the transfer of control.²⁴⁹ Some critics believe that weak

242. PENNINGTON, *supra* note 18, at 327; see Insolvency Act, 1986, ch. 45 §§ 14(1)(a), 17(1)-(2).

243. Insolvency Act, 1986, ch. 45 § 14(5).

244. PENNINGTON, *supra* note 18, at 325.

245. *Id.* at 327. The administrator's decisions must be consistent with the proposal of "purposes" on which the administration order was based. See *id.*

246. Insolvency Act, 1986, ch. 45 § 1(2). The nominee's first function is to prepare and present a report of his assessment regarding the practicability of the voluntary arrangement. FLETCHER, *supra* note 14, at 336. The nominee is empowered to approve the proposal for the voluntary arrangement. *Id.* at 337.

247. See FLETCHER, *supra* note 14, at 335-36; REVISED FRAMEWORK, *supra* note 18, at 10.

248. Lingard, *supra* note 121, at 14.

249. Rajak, *supra* note 225, at 112; see Lingard, *supra* note 121, at 14; see Hill, *supra* note 37, at 51-52.

management causes many corporate insolvencies.²⁵⁰ Thus, the solution is to reform management, not to oust it. It is also preferable to keep old management in place because the original managers have the necessary expertise to run the company.²⁵¹

Some commentators argue that the existence of a debtor-in-possession procedure would promote more successful reorganizations because the procedure would provide management with the necessary incentives to seek insolvency schemes earlier on.²⁵² Managers have an incentive to improve because they usually want to prevent or forestall creditors from seeking liquidation of the company.²⁵³ Hence, one suggestion is to allow pre-existing management to remain, but to address the managerial flaws which cause or contribute to a company's financially troubled state.²⁵⁴ In such a scheme, the nominee or insolvency practitioner would play a smaller advisory role.²⁵⁵

Under the current regime, when management has to "surrender control" while "admitting failure," it is less willing to seek insolvency protection.²⁵⁶ In the United States, Congress knew that ousting incumbent management would make debtors wait longer to attempt reorganization.²⁵⁷ In the United Kingdom, management's unwillingness to transfer control of the business may be a factor contributing to the small number of administrations and voluntary arrangements.²⁵⁸ Furthermore, because insolvency practitioners, rather than the original managers, undertake control

250. Lingard, *supra* note 121, at 14. American commentators also believe that weak management is a significant cause of business failures. Lynn M. LoPucki, *The Debtor in Full Control—Systems Failure Under Chapter 11 of the Bankruptcy Code?* (2d installment), 57 AM. BANKR. L.J. 247, 263 (1983).

251. Lingard, *supra* note 121, at 14.

252. See Hill, *supra* note 37, at 52. In contrast, American commentators have criticized the debtor-in-possession procedure for inappropriately encouraging debtors to seek Chapter 11 protection. See *supra* text accompanying notes 88-90.

253. Lingard, *supra* note 121, at 14.

254. See *id.*

255. See Hill, *supra* note 37, at 52.

256. *Id.*

257. H.R. REP. NO. 595, *supra* note 33, at 233-34 (1977), reprinted in 1978 U.S.C.C.A.N. at 6192-93.

258. See Lingard, *supra* note 121, at 14; Hill, *supra* note 37, at 52. In 1989, there were 43 voluntary arrangements and 135 administrations; in contrast, there were 10,440 liquidations. Hill, *supra* note 37, at 47.

of the troubled company, many administration orders result in liquidation.²⁵⁹

British practitioners recognize the possibility of abuse under the Chapter 11 debtor-in-possession procedure. Yet, the risk of abuse may be preferable to the unfavorable results that occur when the original managers lose their managerial control. In sum, the disincentives created by ousting pre-existing management undermine the Insolvency Act's underlying goal of promoting reorganizations.²⁶⁰

D. Suitability of U.K. Reorganization Schemes for Small Firms

In both the United Kingdom and the United States, the application of one statutory scheme to small and large reorganization cases has proven ineffective. The size of the corporation is critical when determining whether a reorganization attempt will be successful. Small, medium, and large corporations have different considerations once they are in the midst of bankruptcy proceedings. As a result of a wide spectrum of business sizes and forms, it is difficult to create a uniform reorganization procedure to accommodate the variety of businesses.²⁶¹ Although reorganization procedures are fairly new developments in the United Kingdom, there are already strong indicators that the procedures are better suited for larger firms.

1. Cost Barrier

As in the United States, smaller U.K. firms are disproportionately disadvantaged in a reorganization. The British Parliament, however, intended that both small and large companies would be able to employ the procedures under the Insolvency Act.²⁶² Some commentators have also indicated their hopes that the insolvency procedures would be "deployed in even quite small

259. Lingard, *supra* note 121, at 15. Most insolvency practitioners are experienced in selling financially troubled companies, rather than sustaining them. *Id.*

260. For a discussion about the goal of encouraging reorganizations, see *supra* part II.B.2.

261. See LoPucki, *supra* note 62, at 756. See generally Skeel, *supra* note 38, at 509-20 (arguing that a single approach to reorganization is not effective to meet the needs of both closely-held and non-closely-held corporations). Chapter 11 was primarily designed for larger firms; the drafters of Chapter 11 were mainly concerned about larger reorganization cases that are more capable of absorbing the high costs of the procedure. LoPucki, *supra* note 62, at 756.

262. See Hill, *supra* note 37, at 57.

cases."²⁶³ Unfortunately, the current situation proves that reorganization schemes are costly, and are not equally applied to small firms.²⁶⁴ Prior to the enactment of the Insolvency Act, the Review Committee was cognizant of the potential difficulties that small firms could face in using the reorganization procedures. Hence, the Review Committee initially recommended a voluntary arrangement scheme that would not require court involvement,²⁶⁵ resulting in the reduction of costs. The recent Insolvency Act, however, did not incorporate this suggestion.²⁶⁶ In sum, the administration and voluntary arrangement procedures must be affordable in order to be accessible to smaller firms.²⁶⁷

The Chancery Division has stated its concerns about the high costs of reorganization and the resulting effects on smaller firms.²⁶⁸ The court stated that reorganization costs should not undercut the "rehabilitation" goal behind the Insolvency Act.²⁶⁹ "The costs of obtaining an administration order should not operate as a disincentive or put the process out of reach of *smaller companies*."²⁷⁰ Supporting reports that accompany the initial administration application, which are "unnecessarily elaborate and detailed," cause the increase in costs.²⁷¹ As a result, the court has affirmatively stated that "[e]very endeavor should be made to avoid disproportionate investigation and expense."²⁷²

Several British scholars and practitioners have also observed that debtors incur high costs in employing reorganization schemes.²⁷³ High costs are inherent in administrations because administrations require extensive information and a great deal of

263. Anderson, *supra* note 11, at 58.

264. See Jeremy Goldring, *Administrations—Practical Lesson of the First Two Years*, 5 INSOLVENCY L. & PRAC. 2, 8 (1989). In the United States, the costs of Chapter 11 are relatively higher for smaller firms than for larger firms that usually have a bigger reserve from which to draw. Charles M. Tatelbaum, *Chapter 10—Bankruptcy Reorganization for Small Businesses*, 4 FAULKNER & GRAY'S BANKR. L. REV. 33, 33 (1992).

265. Hill, *supra* note 37, at 57.

266. *Id.*

267. See Flaschen & DeSieno, *supra* note 29, at 670. "Inexpensive access" should be an important principle behind any insolvency system. *Id.*

268. Chancery Division Practice Note, [1994] 1 All E.R. 324 (Ch. 1994).

269. *Id.* at 324.

270. *Id.* (emphasis added).

271. *Id.*; see *supra* text accompanying note 141.

272. [1994] 1 All E.R. at 325.

273. Hill, *supra* note 37, at 57; CAMPBELL, *supra* note 10, at 137.

preparation.²⁷⁴ A typical administration will cost a minimum of £20,000,²⁷⁵ which is usually prohibitive for small companies.²⁷⁶ In an administration and voluntary arrangement, a debtor expends a substantial portion of his assets to pay professional fees.²⁷⁷ Time expenditure is another factor that exacerbates the cost barrier for small U.K. firms, as is the situation for small U.S. firms.²⁷⁸ Larger firms, such as Polly Peck,²⁷⁹ have a greater ability to absorb the costs that accrue as a result of a lengthy reorganization attempt. Thus, the trend has been for larger corporations to employ the administration order procedure.²⁸⁰

While voluntary arrangements are less costly than administrations, they are not a solution to the cost barrier. Several considerations push companies to obtain administration orders instead of voluntary arrangements. The absence of a moratorium will force companies to employ the costlier administration procedure, which provides the necessary moratorium.²⁸¹ In order to obtain protection, companies will either employ the administration scheme in conjunction with voluntary arrangements or solely employ the administration procedure. While the voluntary arrangement procedure is less costly, the lack of a moratorium renders it an unattractive choice for many small firms.

2. Recommendation

Several American commentators have suggested proposals that address the difficulty in applying uniform reorganization

274. CAMPBELL, *supra* note 10, at 137.

275. Rajak, *supra* note 225, at 112.

276. Goldring, *supra* note 264, at 8.

277. See Cameron Markby Hewitt, *Rescues of Distressed Companies: The Legal and Practical Issues*, in DEALING WITH FOREIGN WORKOUTS AND INSOLVENCIES 1993: PRACTICAL STRATEGIES FOR LENDERS AND INVESTORS, at 141, 159 (PLI Com. Law & Practice Course Handbook Series No. A-671, 1993). In a Chapter 11 proceeding, professional fees and the costs expended throughout the negotiation process contribute to the higher operating costs. EPSTEIN ET AL., *supra* note 4, at 735. These professional fees comprise a substantial portion of total bankruptcy costs. LoPucki, *supra* note 62, at 731 n.6.

278. LoPucki, *supra* note 62, at 756. Size insensitivity doubles the time necessary to complete a reorganization. *Id.*

279. While Polly Peck was under an administration order, the company attracted negative press comments about the attendant high costs. Hannigan, *supra* note 125, at 1040; see *supra* notes 124-26 and accompanying text.

280. CAMPBELL, *supra* note 10, at 137; *French Shareholders v British Creditors*, ECONOMIST, Aug. 1, 1992, at 64.

281. See *supra* text accompanying note 221.

procedures to both small and large corporate entities;²⁸² these proposals are also instructive in the context of small U.K. firms. These commentators advocate a "context specific" approach, rather than a "one size fits all" reorganization approach.²⁸³ The tailoring of the current administration order procedure could potentially solve the dilemma of small firms.

In the United States, members of Congress and commentators have recommended various ways to improve Chapter 11. One commentator argues that Chapter 11 should have two separate chapters that deal with closely-held and non-closely-held corporations because the Bankruptcy Code does not distinguish between the two types of firms.²⁸⁴ Another solution is the experimental "Chapter 10," which applies to businesses that are indebted in the amount of \$2.5 million or less.²⁸⁵ This chapter would streamline some procedural requirements in an effort to avoid delay; thus, this approach addresses the problems of time delay and costs associated with reorganization.²⁸⁶ To illustrate, "Chapter 10" would decrease the time delay in the following ways: (1) by requiring debtors to file a plan, 45 days after filing the bankruptcy petition; and (2) by requiring a confirmation hearing, 45 days after filing the reorganization plan.²⁸⁷ Therefore, both Congress and critics have recently engaged in substantial discussions about the applicability of reorganization procedures to small firms.

In light of the U.S. proposals to improve reorganization procedures for small firms, the United Kingdom should provide separate provisions, in the administration order procedure, for

282. See generally Skeel, *supra* note 38 (suggesting the splitting of Chapter 11 into two chapters); Tatelbaum, *supra* note 264 (describing a new "Chapter 10" for small firms). Typically, smaller corporations do not succeed in formulating reorganization plans; thus, they are converted into cases under Chapter 7. EPSTEIN ET AL., *supra* note 4, at 734.

283. See Skeel, *supra* note 38, at 510. LoPucki also endorses the concept of separate treatment for small and large cases. LoPucki, *supra* note 62, at 757. See generally Tatelbaum, *supra* note 264 (describing a new "Chapter 10" to address specifically small companies).

284. Skeel, *supra* note 38, at 469. This approach is consistent with the prior system that existed before the Bankruptcy Code of 1978. Skeel vigorously argues that Chapter 11 is ineffective in its present state. See generally *id.*

285. S. 540, 103d Cong., 1st Sess. (1993); Hon. A. Thomas Small, *Small Business Bankruptcy Cases*, 1993 AM. BANKR. INST. L. REV. 305, 320. One bankruptcy judge has informally implemented a system that is similar to the proposed "Chapter 10"; the judge found that this system was effective. Tatelbaum, *supra* note 264, at 40.

286. See Small, *supra* note 285, at 320-21.

287. *Id.* at 320.

small companies. To further simplify the process of obtaining an administration order, some of the required hearings and procedures could be combined together.²⁸⁸ These changes could greatly improve the efficiency of U.K. reorganization schemes for small firms.

The incorporation of a moratorium into the voluntary arrangement procedure is a solution that could transform the procedure into a valuable insolvency option for small firms. The voluntary arrangement procedure is a likely choice for small firms because it is less cumbersome and less costly than the administration order procedure.²⁸⁹ Currently, firms obtain administration orders so that they can avail themselves of the moratorium. The availability of a moratorium will enable firms to obtain the voluntary arrangement alone, without obtaining an administration order.

In light of the criticism of Chapter 11's size insensitivity, the United Kingdom should also modify its reorganization schemes. First, smaller firms are not easily able to use or afford the administration order procedure. Second, while the voluntary arrangement procedure offers advantageous features for small firms, its lack of moratorium protection renders it an ineffective option. Thus, the British Parliament must address these drawbacks in the administration order and voluntary arrangement procedures.

V. CONCLUSION

It is helpful to use Chapter 11 to analyze U.K. reorganization because the two systems share some common policies and a common origin. While Chapter 11 has considerably influenced the recent U.K. Insolvency Act, the United Kingdom did not formulate its insolvency laws in conformity with the Chapter 11 model.

Judicial participation in the reorganization process is a fairly new development in the United Kingdom; hence, previous and upcoming cases have great precedential value. Therefore, commentators and scholars have anxiously awaited the results of the application of U.K. reorganization schemes.

288. This approach would be consistent with the concerns of the Review Committee. "The Court procedure could be substantially streamlined and greatly improved. We cannot believe that there is the need for quite so many applications to, or attendances on, the Court." *INSOLVENCY LAW AND PRACTICE REPORT*, *supra* note 16, at 101.

289. This suggestion is consistent with the initial concerns of the Review Committee. *Id.*

The current situation demands that Parliament consider modifying aspects of the Insolvency Act in order to facilitate a greater number of reorganizations.²⁹⁰ The small number of firms using the administration order and voluntary arrangement procedures demonstrates the need for change. First, the voluntary arrangement procedure must provide moratorium protection. This change would encourage firms to seek reorganization, and would enable the voluntary arrangement to become a more viable option for firms that do not want to obtain administration orders. Second, the United Kingdom should instate a procedure similar to the Chapter 11 debtor-in-possession mechanism. Leaving incumbent management in place would encourage firms to seek reorganization earlier, when rehabilitation is still possible. Lastly, in order to accommodate small firms, U.K. reorganization schemes must become more size sensitive.

Commentators criticize Chapter 11 for creating incentives that encourage debtors to file for bankruptcy inappropriately; in contrast, U.K. reorganization law must create more incentives that encourage debtors to seek reorganization. The United Kingdom has recognized the value of corporate reorganization, but it has not gone far enough with its insolvency law to facilitate "corporate rescues."

*Alexandra Rhim**

290. Rajak, *supra* note 225, at 111.

* This Comment is dedicated to my parents. Special thanks for all the love and support.